Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Harman	Analyst:	Scott McFarlane	Bill Number:	SB 347
Related Bills:	See Legislative History	Telephone:	845-6075	Amended Date:	April 1, 2009
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Employer Provided Health Insurance Credit / FTB Report To Legislature On Or Before September 1, 2013, Regarding Usage Of Credit

SUMMARY

This bill would create a tax credit for taxpayers that provide qualified health insurance for their employees.

SUMMARY OF AMENDMENTS

The bill as introduced on February 25, 2009, was a spot bill. This is the department's first analysis of this bill.

PURPOSE OF THE BILL

It appears the purpose of this bill is to encourage small- to medium-size employers to provide health insurance for employees.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2009, and before January 1, 2015.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Current federal law allows ordinary and necessary business expenses to be deducted, including health care premiums paid by an employer for accident or health plans for employees, and allows self-employed persons to deduct from gross income 100 percent of amounts paid for health insurance for themselves, spouses, and dependents. California law conforms to both of these provisions.

Board Position:			Department Director	Date
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Under current federal law, the amount of an employer's contribution to an accident or health plan for the benefit of an employee or the employee's spouse or dependents, including any salary-reduction contribution made through a cafeteria plan, is excluded from the employee's gross income. California law also conforms to this provision.

For taxable years beginning on or after January 1, 1997, California conformed to the federal provisions that allow an individual to deduct contributions to an Archer Medical Savings Account (MSA); however, California does not conform to any of the federal health savings account (HSA) provisions, including the tax-free rollover from an MSA to an HSA.

THIS BILL

This bill would allow a 15-percent credit for amounts paid or incurred during the taxable year by a qualified taxpayer that provides qualified health insurance for its employees who perform services in California. The credit would be available for taxable years beginning on or after January 1, 2009, and before January 1, 2015.

This bill defines the following terms:

- "Qualified taxpayer" would mean:
  - Any small- to medium-size employer, or
  - Any small- to medium-size employer that has not provided health insurance to their employees employed in California during any of the five taxable years immediately preceding the taxable year.
- "Qualified health insurance" would mean amounts paid on behalf of employees to:
  - A high deductible health plan (HDHP) as defined by Internal Revenue Code (IRC) section 223(c)(2), or
  - An HSA as defined by IRC section 223(d).
- "Small employer" would mean a person, as defined in IRC section 7701(a), employing, for wages or salary, at least two but not more than 50 persons.
- "Medium employer" would mean a person, as defined in IRC section 7701(a), employing, for wages or salary, at least 51 but not more than 250 persons.

This bill would allow the credit to both personal and corporate income taxpayers, and would specify that this credit would be allowed in lieu of any deduction for the same expenses. Any unused credits would be carried over to future years until the credit is exhausted.

This bill would require that on or before September 1, 2013, the Franchise Tax Board would provide a report to the Legislature on the usage of the credit; on or before March 1, 2014, the Legislative Analyst would provide a report to the Legislature on the effectiveness of the tax credit.

TECHNICAL CONSIDERATIONS

This bill defines a qualified taxpayer as any small- to medium-size employer, or any small- to medium-size employer that, during the five taxable years immediately preceding the taxable year, has not provided health insurance to employees. Because a qualified taxpayer would be any small- to medium-size employer, it would be irrelevant whether or not the employer provided health insurance during the preceding five taxable years; therefore, the reference to employers providing health insurance in the previous five years is unnecessary and may lead to misinterpretations of the definition of a qualified taxpayer.

The bill defines a small employer as a person employing at least two but no more than 50 persons, and a medium employer as a person employing at least 51 but not more than 250 employees. These definitions may lead to confusion for employers. For example, if an employer has 45 employees at the beginning of a taxable year, and 55 employees at the end of that taxable year, it is unclear if that employer would be a small-size employer. Or, if an employer has 200 full-time employees, but in addition hires 100 seasonal part-time workers in the summer, it is unclear if that employer would be a medium-size employer. The author may want to provide language that would more clearly define how the number of employees would be measured.

The bill uses the term “person,” as defined in Internal Revenue Code section 7701(a) to define an employer. Such a person can be an individual, trust, estate, partnership, association, company or corporation. However, the bill also uses the term “persons” when referring to the number of persons employed. The dual use of this term may lead to confusion. The author may want to use the term “individuals” instead of “persons” when referring to the number of persons employed.

LEGISLATIVE HISTORY

ABX1 5 (Nakanishi, 2007/2008) was identical to AB 85 (Nakanishi, et al., 2007/2008). That bill was held at the Assembly desk.

AB 85 (Nakanishi, et al., 2007/2008) was similar to this bill, except that the number of employees for small- and medium-size employers was different, and that bill included a category for new small- or medium-size employers. That bill was held at the Assembly desk.

SB 151 (Denham, 2007/2008) would have allowed a credit equal to the amount paid or incurred during the taxable year for qualified health expenses by a qualified employer. That bill failed to pass the Senate Revenue & Taxation Committee.

SB 199 (Harman, et al., 2007/2008) would have created a tax credit for certain taxpayers that provide qualified health insurance for their employees. That bill failed to pass the Senate Revenue & Taxation Committee.

AB 2737 (Nakanishi, 2005/2006), was similar to this bill, except that the number of employees for small- and medium-size employers was different. That bill failed to pass out of the Senate Revenue and Taxation Committee.

SB 195 (Maldonado, 2005/2006)) would have provided a credit to employers for an unspecified percentage of the cost of employee health insurance. That bill failed to pass out of the Senate Revenue and Taxation Committee.

SB 1639 (Dutton, 2005/2006) would have provided a 15 percent credit similar to the 15 percent credit that would be allowed by this bill, except that the credit would not have been limited to small- to medium-size employers. That bill failed to pass out of the Senate.

AB 1262 (Campbell), AB 1734 (Thomson), and AB 2765 (Knox), from the 1999/2000 legislative session, and AB 694 (Corbett) and AB 39 (Thomson/Campbell), from the 2001/2002 session, would have created an employer provided health insurance credit. These bills failed passage in the Assembly.

OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota,* and *New York.* These states were selected due to their similarities to California's economy, business entity types, and tax laws. None of these states were found to provide a credit similar to the credit that would be allowed by this bill.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Based on the data and assumptions discussed below, this bill would result in the following revenue losses beginning in 2009.

Estimated Revenue Impact for SB 347 as Amended April 1, 2009 Effective for Taxable Years Beginning On or After January 1, 2009. ($ in Millions)		
2009-2010	2010-2011	2011-2012
-$75	-$150	-$180

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill.

<u>Revenue Discussion</u>

The revenue impact of this bill would depend on the amount of costs incurred by qualified taxpayers for high-deductible health insurance or contributions to health savings accounts (HSAs) on behalf of employees, tax credits generated, and the amount of credits applied to reduce tax liabilities.

Using available data from the California Employment Development Department, it is estimated that 7,943,000 employees will be working in small- and medium-size businesses in 2009. Available health care industry surveys indicate that approximately 6 percent (≈476,000) of these employees are participating in high-deductible health insurance plans (HDHPs); of those, approximately 46 percent (≈219,000) are participating in self-only coverage, and approximately 54 percent (≈257,000) are participating in family coverage.

Survey information indicates that, on average, employers contribute 88 percent of employees' total annual premium costs for HSA-qualified HDHP self-only coverage and 74 percent of the total annual premium costs for HSA-qualified HDHP family coverage. In addition, 72 percent of employees enrolled in HSA-qualified HDHPs receive contributions from their employers to their HSAs. For 2009, the average employer contribution for employees with self-only coverage is $3,879; of this amount, $3,261 is contributed to annual premium costs, and $618 is contributed to the employee's HSA. The average employer contribution for employees with family coverage is $8,226; of this amount, $7,107 is contributed to annual premium costs, and $1,119 is contributed to the employee's HSA. For purposes of this estimate, it is assumed that average annual premiums and employer contributions will increase by 5 percent per year.

Using average annual costs of $3,879 per employee with self-only coverage and $8,226 per employee with family coverage, the 2009 estimated cost to small- and medium-size employers of providing high-deductible health insurance and contributing to employee HSAs is approximately $3 billion (($3,879 x 219,000 employees with self-only coverage ≈ $.85 billion) + ($8,226 x 257,000 employees with family coverage ≈ $2.15 billion)).

It is assumed that approximately $2.7 billion (or 90 percent) of this total amount is apportioned to California (approximately $3 billion x 90% ≈ $2.7 billion). Potential credits related to providing high-deductible health insurance and contributions to California employees' HSAs would be approximately $400 million for 2009 ($2.7 billion x 15% ≈ $400 million). However, it is assumed that 30 percent of taxpayers entitled to the credit would not report the credit in the initial tax year that the credit is available, with this percentage decreasing to 5 percent by 2012. Available credits estimated to be reported for 2009 are approximately $280 million (approximately $400 million x 70% ≈ $280 million).

Employers currently deduct costs paid on behalf of California employees for an HDHP or an HSA. This bill would prohibit the deduction of any costs for which the credit is allowed. Because the average tax rate of 7.5 percent is one-half of the 15 percent credit percentage, the value of the credit after taking into account the offsetting loss of deductions is approximately one-half of the amount of the credit, or approximately $140 million (approximately $280 million x 50%). Beginning in 2010, it is estimated that 50 percent of the net value of the credit would be applied; however, it is estimated that 33 percent of the net value of the credit would be applied in 2009 due to the limitation on all business credits to 50 percent of tax, resulting in applied credits reported in 2009 of approximately $46 million (approximately $140 million x 33% ≈ $46 million).

Tax year estimates are converted to cash flow fiscal year estimates reflected in the table. For example, the 2009-2010 cash-flow estimate includes $40 million in reduced tax liability for 2009 and approximately $35 million in reduced estimated tax payments for 2010.

POLICY CONCERNS

This bill allows an unlimited carryover period. Consequently, the department would be required to retain the credit on the tax forms indefinitely. Generally, credits include a carryover period limitation because experience shows credits are typically exhausted within eight years.

LEGISLATIVE STAFF CONTACT

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